

To: Honorable David Camp, Chairman, Oversight Committee, House Ways and Means Committee

Re: May 7, 2014 Hearing regarding IRS and 2014 Filing Season

Subject: IRS Audit policies and efficient use of funds

Purpose of Comments: Comments regarding inefficiencies of IRS Audit Practices

Personal background – I am an Enrolled Agent with 7 years of experience as an IRS auditor, and 30 years of experience as a licensed practitioner. I have never been involved with the formation of national policy, but I believe that it may be helpful for Congress to hear from practitioners in the field, who can provide some insight into what it is like to practice at the level that IRS policies are actually implemented. My issue is the sometimes unnecessary burdens put on taxpayers during IRS audits, which do not further the determination of the correct amount of tax, and may be counterproductive in the overall audit goals of the IRS. This unnecessarily uses scarce IRS resources, and over burdensome audits can have detrimental effects to future compliance of taxpayers.

I currently am representing clients in three different audits. In all three of these audits I believe the IRS has overstepped their bounds, and auditors are spinning their wheels in a way which wastes the IRS auditors time, will result in little or no additional tax, but places an unneeded burden on the taxpayers. I would like to use one current audit as an example.

This audit involves an income probe of a couple who each have a small moonlighting business on the side in addition to their regular W2 wages, which are over 200,000 between them. Total gross income for the two Schedule C's is less than \$4,000. I did not prepare the original tax return, but when the taxpayers retained me to represent them, and brought me copies of their tax returns to review I could immediately see significant potential problems with expenses. Problems with expenses include some items which are not deductible, some items which are obviously estimates, and may be overstated, and some items which appear to be in the nature of employee business expenses, and need to be re-classified to Schedule A, subject to the 2% threshold, and AMT. The IRS is completely justified in auditing this return, and in opening the prior, and following year for audit to adjust these expenses.

My issue is with their income probe. As someone with 37 years of experience in taxation, I can look at the return and see that is not where the problem is going to be. After having audited a number of similar returns during my time as an auditor, as well as having defended the issue a number of other times, it just isn't there. The taxpayers are showing more than adequate total income on their returns, and each of these Schedule C's is a small part time business. Neither business is a cash business, both receive income from other businesses for which 1099's are issued. There is just nothing there. Is there a possibility that a small amount of cash might have been received on the side? Anything is possible, but if it has happened, it would be a very minor amount.

The initial audit letter did not include a request for bank documents. After contacting the

auditor, and schedule an appointment, a subsequent information request was issued asking for bank records. Hoping to avoid unnecessary work for the auditor, and the taxpayers, and hoping that the auditor has shared similar experiences to mine on audits like this, I requested from the auditor that this request be dropped, which the auditor declined to do. OK, I acknowledge the IRS's right to request bank records, and they were provided for the initial appointment, even though this will be a waste of everyone's time.

In my interview with the taxpayers prior to the audit, the disclosed that they had received some cash from the husband's parents to invest in a corporation being started. This cash was deposited to the taxpayers personal accounts, and then transferred to a corporation account. This corporation was starting a Care Home, for which there are extensive licensing requirements. According to the taxpayer, the license was not received until 2014. In the year in question, 2013, the corporation had no taxable income, and any expenditures would have been non-deductible start-up expenses. This information was disclosed to the auditor.

The result of the initial income probe, per the auditor, there were "unidentified" deposits of about \$65,000. Amounts not "identified" included new W2 wages of the husband of about \$45,000, which the auditor did not allow as a source since the specific net paychecks were not identified, and deposits in even amounts of a little bit over \$20,000, consistent with the taxpayers story of money received from the parents to invest in the corporation. With the 37 years of experience that I have, if I was the auditor, that would be enough right there to stop wasting further time, and write up income as verified, and move on to expenses, where there will be substantial changes. We could be done with this audit right now.

Unfortunately, the auditors are determined to spin their wheels, and I expect it will be six months or more before this is finished. First of all, the auditor requested bank records for the corporation. While I did explain, again, that there would be nothing there, I also took the position that the request to look at the bank records for an entity is an examination of the books and records of that entity, and constitutes an audit. This, as admitted by the IRS group manager, is part of the IRM. I do recognize the authority of the IRS to open a related entity for an audit, but I requested that if the IRS wanted to do so, they need to issue a formal audit letter. That way, at the end of the audit, the corporation gets a "no-change" letter, which makes it very difficult for the IRS to re-open a case at a later time. While this is not the legal protection against double jeopardy that one gets in a criminal case, it is a substantial protection against the IRS demanding to examine the same books on multiple occasions, and is a protection that I feel justified in demanding.

Well ... this position has apparently really angered the group manager, that I could challenge the IRS's right to expand the audit without going through proper formalities. At the end of the first meeting, the auditor indicated that, if we could verify the source of the "additional" 65,000 in deposits, income would not be an issue for the related years, but we could focus on expenses, where we both agree there are problems. After forwarding my refusal to provide corporation records without a formal audit notice to the group manager, the manager called me, with attempts to intimidate me. After that, we received a new information request for the prior and subsequent years, with a full demand for bank records, and an income probe for those years as well. Even though, I already have an explanation for, even if not final proof, of the total deposits

for the first year in question.

While I recognize the IRS authority to request “proof” of these items, at this point, we are just spinning our wheels, and we will ultimately get nowhere. Unfortunately, the IRS does not react very well when they are challenged about overstepping their authority, but expect anyone to go along with whatever demands they chose to make. An auditor, or group manager sometimes will do their best to make it difficult for anyone who does not accept any demand that they make.

My view is somewhat different. My feeling is the IRS does need to be challenged when they overstep their authority, and/or request numerous records, which place extra burdens on taxpayers, but are not likely to result in substantial additional changes to tax. Auditors really need to exercise more judgment, created by training and experience, in deciding what issues are worth follow-up, and what items will be a waste of time.

Am I concerned about the results of the audit? Not really. My 37 years of experience tells me that there will ultimately be no adjustments to income after jumping through the hoops demanded by the auditor and group manager. My experience also tells me that, after challenging the manager’s authority, we will probably not be able to settle this case at the audit level. I expect that, under the manager’s orders, the auditor will probably disallow all, or substantially all expenses claimed, even though quite a few are legitimate. I expect to be able to reach a reasonable compromise at Appeals, at an even greater cost to the IRS (it will cost my clients nothing, as I will not charge them for any additional time required because of my challenge to the IRS authority). I also expect that the taxpayers will have me prepare future returns, where I will claim specific allowable amounts on the correct place on the tax return.

Sometimes I can remember my first six weeks of training as an IRS auditor as if it was yesterday. Some of the basic concepts of that training have stuck with me through all of the subsequent years of my career. A part of that training was a discussion of general audit policy, and an auditors place in the system. The first emphasis was an auditor’s job to determine the correct tax liability. A second, but perhaps equally important goal, as taught was to increase future voluntary compliance. There was an acknowledgement back in those days that the IRS will never have the resources to audit every return filed, or even a significant portion of returns filed. The goal of an audit then, besides collecting some extra tax, was to create an atmosphere where the taxpayer would be more likely to voluntarily comply with filing their tax return correctly in the future after an audit. Sadly the IRS seems in the past two generations to have forgotten this of the audit formula.

As I interpreted what I was taught, promotion of voluntary compliance through audit was first about education. Explaining what a taxpayer had done wrong, and what they needed to do in the future. Sometimes, and this is where some judgment is called for, a taxpayer is deliberately gaming the system. In that case a little stronger action is called for, anything from letting a taxpayer know that they have had their hand slapped, to a full criminal investigation. There are taxpayers who will continue to abuse the system, and sometimes putting the fear of the IRS into someone is a needed function of conducting an audit.

However, many times a taxpayer, simply does need just some education. Their errors may be

totally out of ignorance of a very complex set of laws, or they may have been made because a taxpayer got bad advice, from a friend, neighbor, etc. or they simply feel that everyone does this, so they should be able to do that also, based on some widely held “urban myths”, such as that the “rich” don’t pay any taxes, so why should they.

In any case, unneeded requests for information, that go nowhere, do not result in any significant changes to tax, create an unnecessary burden on a taxpayer, even when they are in the wrong in certain areas, and, in at least some cases, a resentment of how they were treated, with sometimes predictable results, that can detrimentally affect future voluntary compliance. In general, if taxpayers feel that they have been treated fairly, even if that treatment involves a spanking, they are more likely to voluntarily to comply in the future, than if they feel the IRS has abused it’s power.

Another, and related, part of the audit equation from the auditor’s side was a goal to impact as many taxpayers as possible. If the IRS does not have the time to audit a taxpayer, who has made mistakes on their return, that opportunity for education is lost. If an auditor spins their wheels for ten-twelve hours or more in an audit, and ultimately gets nowhere that is ten or twelve hours that they cannot be auditing someone else that they could have had an impact on.

Auditing is not an easy job. It does require judgment calls, and no auditor will come up with the right answer every time. I feel the IRS does need to look at policies and training developed over the past few decades, and see how it can get auditors to more effectively using their time by quickly recognizing key issues, devoting needed time on those issues, and spend less time chasing wild geese. It is possible to achieve some positive results for future voluntary compliance of some attitudes and procedures are changed.